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BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS

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Arizona Corporation Commission

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AZ CORP COMMISSION
DOCKET CONTROL

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IN THE MATTER OF THE APPLICATION OF
CHAPARRAL CITY WATER COMPANY FOR
A DETERMINATION OF THE CURRENT
FAIR VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR AN INCREASE IN ITS
RATES AND CHARGES BASED THEREON.

DOCKET NO. W-02113A-13-0118

ORIGINAL

STAFF'S NOTICE OF FILING

The Utilities Division ("Staff ") of the Arizona Corporation Commission ("Commission")
hereby files its witness summaries in the above docket.

Staff will present three witnesses: Gerald Becker- presenting Staffs analysis and
recommendations in the areas of rate base, operating revenues and expenses, revenue requirement,
and rate design recommendations in the rate case; John Cassidy- presenting Staffs recommendations
regarding cost of capital; and Katrin Stukov- presenting Staffs engineering analysis and
recommendations.

RESPECTFULLY SUBMITTED this 14th day of February, 2014.
Matthew Laudone
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Original and thirteen (13) copies of
the foregoing filed this 14th day of
February, 2014, with:

Docket Control
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TESTIMONY SUMMARY
JOHN A. CASSIDY
CHAPARRAL CITY WATER COMPANY
DOCKET NO. W-02113A-13-0118
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The testimony of Staff witness John A. Cassidy addresses the following issues:

Direct:

Capital Structure – Staff recommends that the Commission adopt a hypothetical capital structure for Chaparral City Water Company (“Company”) for this proceeding consisting of 40.0 percent debt and 60.0 percent equity.

Cost of Equity – Staff recommends that the Commission adopt a 9.3 percent return on equity (“ROE”) for the Company. Staff’s estimated ROE for the Company is based on the 8.7 percent average of its discounted cash flow method (“DCF”) cost of equity methodology estimates for the sample companies of 8.1 percent for the constant-growth DCF model and 9.3 percent for the multi-stage DCF model. Staff’s recommended ROE includes an upward economic assessment adjustment of 60 basis points (0.6 percent).

Cost of Debt – Staff recommends that the Commission adopt a 5.9 percent cost of debt for the Company.

Overall Rate of Return – Staff recommends that the Commission adopt a 8.0 percent overall rate of return.

Ms. Ahern’s Testimony – The Commission should reject the Company’s proposed 11.05 percent ROE for the following reasons:

Ms. Ahern’s single-stage constant growth DCF estimates rely exclusively on analysts’ forecasts of earnings per share growth to calculate the dividend growth (g) component. Ms. Ahern overstates the current dividend yield (D_0/P_0) component by using a 60-day average stock price (P_0) value, and she inflates the expected dividend yield (D_1/P_0) component by means of semi-annual compounding. Ms. Ahern’s risk-premium model cost of equity estimates derived from the CAPM, ECAPM and PRPM models are inflated due to the use of a risk-free (R_f) rate calculated as an average of historical measures and forecasted estimates of the 30-year U.S. Treasury yield. Ms. Ahern’s indicated cost of common equity before adjustments for risk is based upon estimates derived from her DCF (8.84 percent), RPM (11.04 percent) and CAPM (10.75 percent) estimation methodologies; however, her 10.48 percent indicated cost of equity exceeds the arithmetic mean of the results obtained from her models and, thus, appears to be overstated. Ms. Ahern’s recommended cost of equity includes an upward 18 basis point credit risk adjustment and an upward 40 basis point business risk adjustment.

TESTIMONY SUMMARY
JOHN A. CASSIDY
CHAPARRAL CITY WATER COMPANY
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Surrebuttal:

Capital Structure – Staff recommends that the Commission adopt a hypothetical capital structure for Chaparral City Water Company (“CCWC” or “Company”) for this proceeding consisting of 40.0 percent debt and 60.0 percent equity.

Cost of Equity – Staff recommends that the Commission adopt a 9.6 percent return on equity (“ROE”) for the Company. Staff’s estimated ROE for the Company is based on the 9.0 percent average of its discounted cash flow method (“DCF”) cost of equity methodology estimates for the sample companies of 8.6 percent for the constant-growth DCF model and 9.4 percent for the multi-stage DCF model. Staff’s recommended ROE includes an upward economic assessment adjustment of 60 basis points (0.6 percent).

Cost of Debt – Staff recommends that the Commission adopt a 5.2 percent cost of debt for the Company.

Overall Rate of Return – Staff recommends that the Commission adopt a 7.9 percent overall rate of return.

Ms. Ahern’s Testimony – The Commission should reject the Company’s proposed 10.50 percent ROE for the following reasons:

Ms. Ahern’s single-stage constant growth DCF estimates rely exclusively on analysts’ forecasts of earnings per share growth to calculate the dividend growth (g) component. Ms. Ahern overstates the current dividend yield (D_0/P_0) component by using a 60-day average stock price (P_0) value. Ms. Ahern’s risk-premium model cost of equity estimates derived from the CAPM, ECAPM and PRPM models are inflated due to the use of a risk-free (R_f) rate based upon forecasted estimates of the 30-year U.S. Treasury yield. Ms. Ahern’s recommended cost of equity includes an upward 32 basis point credit risk adjustment and an upward 40 basis point business risk adjustment.

Double Leverage- Staff has concerns that use of CCWC’s reported December 31, 2012 test-year end capital structure in this rate proceeding may harm ratepayers, as the Company’s disproportionately high level of reported common equity may instead be supported by debt issued at the ultimate parent or intermediate parent level. This circumstance is commonly referred to as, double leverage.

TESTIMONY SUMMARY
GERALD BECKER
CHAPARRAL CITY WATER COMPANY
DOCKET NO. W-02113A-13-0118
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The testimony of Staff witness Gerald Becker addresses the following issues:

Direct:

1. Utility Plant in Service and Accumulated Depreciation
2. Deferred Debits – Adjustment to proposed post in service AFUDC and depreciation deferral
3. Working Capital
4. Excess Water Loss Adjustment
5. Incentive Compensation and Contributions and Dues
6. Purchased Water Expense
7. Depreciation Expense and methodologies
8. Income Taxes
9. Property Taxes
10. Rate Design

Surrebuttal:

Mr. Becker addresses the specific issues listed below that are discussed in the rebuttal testimony of Company witness. He also sponsored the attached schedules GWB 1 – 18.

1. Post Test Year Plant – Staff agrees with most of the items of post-test year plant as reflected Company's rebuttal position.
2. Accumulated Depreciation and Fully Depreciated Plant – Staff has recalculated its Accumulated Depreciation balance and has changed its treatment of some plants was treated as fully depreciated.
3. Working Capital – Staff agrees with the Company's position that interest payments are subject to a lag of 91.25 days instead of the 106.25 days and has made a minor correction to the Customer Accounting balances. Staff has adjusted its cash working capital calculation accordingly.
4. Incentive Compensation – Staff has not adjusted its disallowance, as the Company has yet to support the balance. Further, Staff has also disallowed allocations related to the payment of contributions, dues, memberships, allocated from the parent level.
5. Depreciation and Amortization Expense – Staff has recalculated Depreciation Expense to reflect the removal of some plant that was previously treated as fully depreciated and made minor correction to the amortization of Contributions in Aid of Construction.
6. Rate Design – Staff has not fundamentally changed its rate design but recalculates rates and bill impacts to reflect the revenue requirements discussed herein.

**TESTIMONY SUMMARY
KATRIN STUKOV
CHAPARRAL CITY WATER COMPANY
DOCKET NO. W-02113A-13-0118
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The testimony of Staff witness Katrin Stukov addresses the following issues:

Conclusions:

1. The Arizona Department of Environmental Quality ("ADEQ") or its formally delegated agent, the Maricopa County Environmental Services Department ("MCESD"), has reported that the Chaparral City Water Company's ("CCWC" or "Company") water system (PWS No. 07-017) is currently delivering water that meets water quality standards required by 40 C.F.R. 141 (National Primary Drinking Water Regulations) and Arizona Administrative Code, Title 18, Chapter 4.
2. Based on the Company's water use data for the test year, Arizona Corporation Commission ("ACC") Utilities Division Staff ("Staff ") concludes that the Company's water system has adequate water supply and storage capacities to serve the present customer base and reasonable growth.
3. The Company's water system has a water loss of 13.9 percent. This percentage is above the recommended threshold amount of 10 percent.
4. The Company's water system is located in the Phoenix Active Management Area ("AMA").
5. The Arizona Department of Water Resources ("ADWR") has determined that the Company's water system is currently in compliance with ADWR requirements governing water providers and/or community water systems.
6. The Company has no outstanding ACC compliance issues.
7. The Company has an approved curtailment plan and backflow prevention tariffs on file with the ACC.

TESTIMONY SUMMARY
KATRIN STUKOV
CHAPARRAL CITY WATER COMPANY
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Recommendations:

1. Staff recommends that the Company's reported annual water testing expense of \$2 1,754 be accepted for this proceeding.
2. Staff recommends the depreciation rates delineated in Table A.
3. Staff recommends the acceptance of the Company's requested service line and meter installation charges, as delineated in Table B.
4. Staff recommends approval of the Best Management Practices ("BMPs") listed in attachments A and B. Staff further recommends that the Company notify its customers, in a form acceptable to Staff, of the BMP tariffs authorized in this proceeding and their effective date by means of either an insert in the next regularly scheduled billing or by a separate mailing and provide copies of the BMP tariffs to any customer, upon request. The Company may request cost recovery of actual expenses associated with the BMPs implemented in its next general rate application.
5. Staff recommends that the Company ensure the accuracy of all meters in its water system (including meters indicating gallons purchased/pumped) and be required to report accurate information in its Water Use Data Sheet in future Annual Reports and other fillings.
6. Staff recommends that the Company continue to record and monitor monthly water losses, repair any leak as soon as it is discovered and implement a deteriorating infrastructure replacement plan as discussed in the Company's System Improvement Benefits Mechanism ("SIB") Eligibility Report and SIB Plant Table I.
7. Staff recommends approval of the Company's SIB Plant Table I eligible projects for purpose of SIB approval.
8. If the Commission approves a SIB, Staff recommends that the Company be required to file with Docket Control, as a compliance item in this docket, within 30 days, of the effective date of this Decision, a Plan of Administration ("POA") for the SIB mechanism, consistent with Attachment C for Staff review and approval.